

# Alternative Expansion Models

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# Introductory Remarks

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- Why Seek Alternatives?
  - Saturation of Home Market
  - Opportunity to Expand Outside of Home Market
  - Beat or Meet the Competition

# The Target Market

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- Political Climate
- Demand for Franchisor's Product or Service
- Competition

# The Target Market ...

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- Tax and Import/Export Concerns
- Restrictions on Repatriation of Funds
- Available Capital and Human Resources

# The Target Market...

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- Ability to Replicate Domestic Success?
- Labour Supply Issues
- Source of Supply for Products and Services
- Ability to Maintain and Enforce Standards
- Immigration Restrictions for Head Office Personnel

# The Target Market Cont

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- Legal Issues and Restrictions
  - Laws Specific to the Industry
  - Intellectual Property Protection
  - Advertising and Labelling Requirements
  - Transfer or Termination Issues
  - Competition Act Issues
  - Employment Law Issues

# Finding the Right Candidate

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- First With the Money?
- Relevant Considerations
  - In-depth knowledge of the target market
  - Management Expertise
  - Business Acumen
  - \$Money\$

# Choosing the Expansion Method

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- Significant Consequences if Wrong Vehicle Chosen
  - Cost of Failure
    - Financially
    - Diverted Focus and Commitment of Resources
  - Loss of Market Share
  - Damage to Future Expansion Plans
  - Damage to Brand



# Choosing the Expansion Method

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- Conflicting Considerations:
  - Distance of Target Market from Home Jurisdiction
  - Speed of Market Expansion
  - Cost of Expansion
  - Share of Profits
  - Quality Control and Maintaining Consistency
  - Limited Number of Prospects
  - Limiting Liability
  - Availability of Human Resources and Training Resources
  - Familiarity with Target Market

# Licensing and Distribution...

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- ❑ 3 Essential elements of a Franchise
- ❑ Right to Distribute Goods or Services in Association with the Franchisor's trade-marks
- ❑ Payment of a Fee or other Consideration, single or continuing, for the Grant of Rights
- ❑ Significant Assistance or Control by the Franchisor

# Licensing and Distribution...

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- Alternatives to Franchising
- Distribution of Franchisor's Product in Target Market
- License of patent or process to manufacture product for sale

# Licensing and Distribution

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- Types of Distribution Arrangements
- Sales Agency
- Dealership
- Distributorship
- Simple Licensing

# Unit or Direct Franchising

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- Simplest Method but Slower Growth
  
- Grant of rights by Franchisor:
  - Directly to the franchisee
  - Right to Establish a Single Franchised Unit

# Area Representation ...

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- Right to Recruit Franchisees
- Franchisees Contract Directly with Franchisor
- Exclusive Territory
- Delegation of Training, Supervision and Support
- Sharing of Initial Fees and Royalties
- Administration of Advertising and Promotion

# Area Representation

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## □ Advantages

- Greater control over pace of development
- Delegation by Franchisor of training and support obligations

## □ Disadvantages

- Representative may be less committed due to smaller required investment
- Franchisor is direct target for claims by franchisees and third parties

# Area Development...

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- ❑ Rights to a single Developer to Establish a Number of Outlets
- ❑ Exclusive Territory
- ❑ Development Schedule



# Area Development

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## □ Advantages

- Single Franchisee
- Cost Effective

## □ Disadvantages

- Slower Growth
- Outlets are Managed, not Owner-Operated
- Risk of Tension between Franchisor and Developer
- Risk of Failure by Developer to Maintain Presence in Territory

# Master Franchising - Advantages

- Efficient Means of Expansion
  - Language, Legal System, Customs
  - Distance
  - No Available Personnel in Target Market
- Download tasks in domestic market to MF
- Infusion of Cash
- Rapid Expansion?
- Preempt Competition

# Master Franchising - Disadvantages

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- Lower Profits due to Fee Splits
- Difficult to Locate Qualified MF
- Development Schedule may Impede Speed of Growth
- Greater chance of Failure and Loss of Control

# Master Franchising - Due Diligence

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- Finding the Right Candidate (as before)
  - Mutual/Shared Goals and Views
  - Financial Strength of MF
- Research on Territory
  - Market Research, Language, Religion, Laws
- Support and Training
- Cost of Development
  - Prior and Post Grant

# Master Franchising - Practice

## Tips...

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- Letter of Intent
- Ensure Satisfactory Sources of Revenue and Fee Splits
  - For Both Zor and MF
- Cost Recovery
  - Deposit from MF Prospect
  - Letters of Credit from MF
- Local Counsel

# Master Franchising - Practice

## Tips

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- Review Localized Manual, FA and DD
- Territory Size & Strategies for Expansion
- Reservation of Rights
- Development Quotas
- Length of Term
- Degree of Supervision
- Treatment of Unit Zees on Failure of MF

# Joint Venture...

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- Akin to a Partnership
  - Shared Risk
  - Shared Control
- Franchisor Brings Know-How, Proprietary Information
- Developer Brings Financial and Human Resources

# Joint Venture

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- ❑ Least risky Franchise Method
- ❑ May be only Vehicle Available in certain markets
- ❑ Local Joint Venture Partner may Bring Access to Government Subsidies/Favourable Tax Status
- ❑ Franchisor has Greater Control over Target Market Franchised Entity
- ❑ Franchisor Participates in Potential Profits



# Other Methods of Franchising...

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- Corporate Expansion/Dual Distribution
  - Pros
    - Building Asset Value on Balance Sheet
    - Maintain Control
  - Cons
    - Cash Flow Pressures
    - Conflict of Interest Issues
    - Encroachment Issue (Could be Managed)

# Other Methods of Franchising...

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- Conversion Franchising
- Of Competing Systems (By Acquisition) or Corporate Owned Units
- Pros
  - Rapid Expansion Possible
  - Trained and Knowledgeable Zees
- Cons
  - Encroachment Issues
  - Reluctantly Trained Zees

# Other Methods of Franchising...

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- Co-Branding
  - Related (YUM Brands - Pizza Hut/KFC/Taco Bell)
  - Unrelated (Country Style/Yogen Früz)
- Pros
  - Rapid Expansion
  - Captive Market
  - Brand Synergies
- Cons
  - Difficult Enforcement Issues
  - Increased Costs to Franchisees
  - Complex Negotiations as between Co-Branded Zors
  - Profit Splits

# Other Methods of Franchising

- Non-Traditional/Special Venues
  - Kiosks, Stadiums, Hospitals, Carts, Amusement Parks, Airlines, Home Delivery...
  - Pros
    - Reduced Costs/Improved Margins
    - Unserved Market Segment
    - Rapid Expansion and Market Penetration
  - Cons
    - Encroachment Issues
    - May be Seasonal, Too Mobile
      - Difficult to Control the Brand

# Disclosure Document Issues...

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- ❑ Educate yourself on local laws
- ❑ Disclosure Document follows negotiation of development agreement
- ❑ Disclaim Franchisor's experience in the target market

# Disclosure Document Issues

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- Retain Local Counsel
- Conform DD and MFA/FA to Local Law
  - Relationship with Zor
  - Costs of Establishing the Business
  - Trade-marks Registration and Licensing
  - Currency, Taxes, Language Issues
  - Governing law
- At whose Cost and with what Degree of Supervision?
- Combined Unit and ADA/MF Disclosure in 1 Doc?

# Conclusion and Questions

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